Five Financial Mistakes You Should Avoid

These simple steps might save you a great deal of money and heartache

We all make mistakes, and through them, we learn. But when it comes to finances, it is best not to take the trial-and-error approach.

Maybe you're making some simple mistakes that can be fixed with a little bit of effort. Your financial advisor can help.

Five Financial Mistakes to Avoid

Avoiding some of the following financial mistakes might save you a great deal of money and heartache.

1. Cashing out a retirement account to pay off loans. Substantial income tax penalties can hit you if you tap into retirement accounts before a certain age. Even if there are no penalties, cashing out an entire account at once potentially puts you in a higher tax bracket.

The amounts you withdraw before you reach 59½ are called early or premature distributions. They may be subject to an additional 10% tax. (As always, there are some exceptions to this rule, so consult with a qualified financial advisor or the Internal Revenue Service.)

The COVID-19 pandemic forced many people to tap into retirement accounts to pay mounting bills and loans. This was a measure of last resort, but the moral of this story is: If you have to take a distribution, you should at least understand the tax implications up front and mitigate the impact.

2. Missing retirement account rollover dates. You can move your wealth around by receiving a check from a qualified retirement account and deposit that money into another retirement account within 60 calendar days.

If you miss the deadline, the IRS treats the amount as a taxable distribution. Further, your 401(k) plan provider withholds 20% for federal income taxes. You have to add funds from other sources equal to the gross distribution to avoid possible tax penalties.

The lesson here? Rollover your accounts using a trustee-to-trustee transfer whenever possible. Having your custodian send your funds to another directly may be a better way to do a rollover.

3. Failing to update beneficiaries. Forgetting to remove a former spouse's name as the beneficiary on retirement accounts or insurance policies happens. This could result in failing to provide for your children, a new spouse or other loved ones. Check your beneficiary designations annually and when a major life transition, such as a marriage, divorce or birth, occurs.

4. No will. If you do not have a will, when you die, the laws of intestacy determine who receives your assets. Drafting a will helps you maintain control of these important matters. Speak with an attorney to discuss preparing a will that documents where you want your money to go when you're gone. Once you draft the will and name the beneficiaries or guardians, review it every few years and when things in your life change.

5. No power of attorney. A power of attorney (or POA) is an important document that allows you to select a point person (often a spouse or trusted family member) to make decisions on your behalf. This person can access your finances and help with bills, medical expenses and sign tax returns.

If you do not have a POA in place, and you become incapacitated, your family has to petition the courts for a conservatorship. This process often takes months, costs thousands of dollars and thus compounds the financial pressure.

The lesson here is to speak with an attorney to help select a POA, and while you're at it, discuss a health-care proxy, your agent would make medical decisions on your behalf, should you be unable to convey your wishes.

Your Financial Advisor

Ensuring your financial house is in order presents some complicated issues that require expert advice.

Find a financial advisor who knows how to deal with these types of issues. Find a financial advisor who knows the ins and outs of various retirement accounts. Find a financial advisor who accounts for unexpected cashflow crunches. Find a financial advisor who understands how emotions can interfere with your investing plans. Find a financial advisor who understands your goals.

Then make a smart decision and have your financial advisor build you a custom–tailored financial plan. So you can sleep better at night.